Peyto Oils Ltd.

1978 Annual Report

PEYTO OILS LTD. and Subsidiaries

Peyto Explorations Inc. 100%
Giant Reef Petroleums Limited 83%

Not included in consolidation:
Enjay Holdings Limited 40%

HEAD OFFICE:

Suite 1650, 633 - 6th Avenue S.W.
CALGARY, Alberta. T2P 2Y5
Area Code 403-261-5042
Telex 03-825862
Call Back Peyto Oils CGY

OFFICERS:

R. T. VANDERHAM — *President*
W. C. KERR — *Secretary*
J. E. MORRISH — *Assistant-Secretary*

DIRECTORS:

CARMEN W. BYLER
JEAN LeREUN
R. T. VANDERHAM
W. WOLODARSKY

BANKERS:

BANK OF MONTREAL
604 - 8th Avenue S.W.
CALGARY, Alberta. T2P 1G4

REGISTRAR AND TRANSFER AGENT:

MONTREAL TRUST COMPANY
411 - 8th Avenue S.W.
CALGARY, Alberta. T2P 1E7
15 King Street West
TORONTO, Ontario. M5H 1B4

AUDITORS:

PEAT, MARWICK, MITCHELL & CO.
2500, 700 - 2nd Street S.W.
CALGARY, Alberta. T2P 2W2

STOCK LISTING:

TORONTO STOCK EXCHANGE
STOCK SYMBOL — PYT

Annual Meeting shall be held Oct. 13, 1978 at the Board Room of the Montreal Trust Company, 411 - 8th Avenue S.W., CALGARY, Alberta.

On our cover is PEYTO LAKE located 27 miles north of Lake Louise on the Banff-Jasper highway in Banff National Park.

COMPANY PROFILE

May, 1966 — Company incorporated in Alberta as private oil & gas exploration & producing company.

Jan., 1969 — Public share offering, 300,000 shares at $.75/share.

Nov., 1969 — Private share placement, 300,000 shares at $2.25/share.

May, 1970 — Issuance of 573,293 shares to acquire 65% controlling interest in Giant Reef Petroleums Limited.

Nov., 1970 — TORONTO STOCK EXCHANGE listing 1,755,293 shares outstanding.

Nov., 1971 — Private share placement 200,000 shares at $2.00/share.

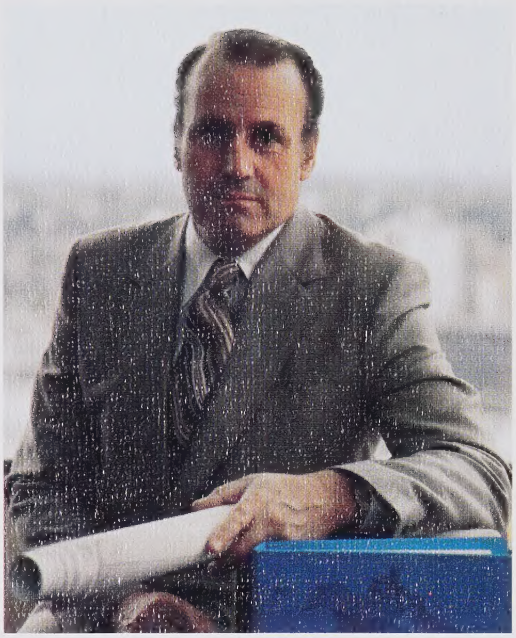
1971-1972 — Drilling Fund obtained for $750,000.

Jan., 1973 — Issuance of 383,328 shares to acquire Polaris Oil Ltd. and its subsidiary companies.

Nov., 1973 — Private share placement 350,000 shares at $6.00/share to Francarep one of the French Rothchild group of companies. Subsequently M. Jean LeReun joined the Board of Directors as their representative.

Jan., 1977 — Drilling fund obtained for $3 million, granted option to acquire 160,000 shares at $5.50/share.

Battle Creek No. 1 Discovery Well.



TO OUR SHAREHOLDERS:

Peyto experienced its most active year to date with sharp increases in exploration and development drilling and satisfactory improvements in production of both oil and gas, and earnings.

In addition to its own funds, substantial benefits were derived from the 1977-1978 Limited Partnership Fund which made $3 million available to the company to aid in the search for hydrocarbons.

The company has matured to a stage where its internally generated cash flow will sustain a reasonably aggressive exploration program.

With this in mind we are presenting to you in this report several charts and statistics showing the performance of your company over the last five years. Increasingly rates of return and growth of reserves are receiving greater emphasis. Although declaration of dividends can at this stage of our growth not be entertained, it being the opinion of your Board that the company's cash flow should be reinvested in the business, at some future date it is hoped that dividend payments can be initiated.

The rate of return on the shareholder's equity in the company at present is inadequate and not commensurate with the risk involved in searching for oil and gas. Your management aims to reach a rate of return of 18% to 20%. It is gratifying to note the steady improvement made in this respect to date. Further improvements are expected in the coming year despite the fact that current funds invested in successful exploration for natural gas will not yield a return until a market for such gas is developed. The outlook for an expansion of the natural gas market within 2 to 3 years is not encouraging.

Your company follows the "successful effort" method of accounting as opposed to the "full cost" method generally used by the junior oil companies. Under the successful efforts method only the cost of successful wells are capitalized with all other expenditures such as lease rentals, dry holes and some geological exploration costs, overhead and interest charges being written off in the year in which they are incurred. This has the effect of causing wider swings in such earnings from year to year reflecting the increased or decreased expenditures made on exploration. You will note for instance that this year's earnings were decreased by $756,659 because of dry holes and abandonments in our exploration expenditures, an increase of $537,250 over last year. Despite the disadvantages of the successful efforts method it is your Board's opinion that this method is the more conservative and realistic to present the company's financial affairs.

The business climate in Alberta has by and large been favorable for the oil industry. A strong upward movement in prices received for our products together with increased volumes is contributing to our financial success. Returns from our Saskatchewan production, however, remain totally inadequate due to Government imposed mineral taxes and no further exploration in that Province is contemplated until the outlook improves. In British Columbia we have increased our activity cautiously. Despite the election of the present conservative Government we are not convinced that a socialist government could not be elected again. Socialist provincial governments have, in the past, been less than sympathetic to the oil industry.

The company's aims are to continue to generate and to develop oil and gas prospects in Western Canada, to explore opportunities found in the United States, to make corporate acquisitions, and lastly to maintain modest exposure to foreign exploration plays in areas where large accumulations of oil and gas could occur and where the initial investment in obtaining concessions is small. In the final analysis the shareholders of the company can only benefit from a continued growth in earnings and profitable assets.

The highlights of the year were:

1) the continued successful development of our Battle Creek gas field in Montana where, following the drilling of 35 wells of which 75% were successful, the "pay or take" provision of our gas contract came into effect on August 28, 1978.

2) the proposed sale of our U.K. subsidiary, holder of Block 3/7 in the North Sea to Deminex for $2 million.

3) increases in land holdings which now total 12,917,959 gross acres and 1,289,272 net acres.

4) the drilling of 6 successful gas wells in Alberta.

5) the decrease in our bank loan from $5,000,000 to $3,050,000.

Peyto is proud of its small but highly efficient staff. Our employees have proven to be diligent and loyal, and the Company's Board of Directors is grateful to them.

R. T. Vanderham,
President.

September 15, 1978

FINANCIAL

Earnings

For the year ended May 31, 1978 net earnings amounted to $1,110,000 ($.39 per share) a gratifying increase over the previous year when net earnings amounted to $736,000 ($.26 per share).

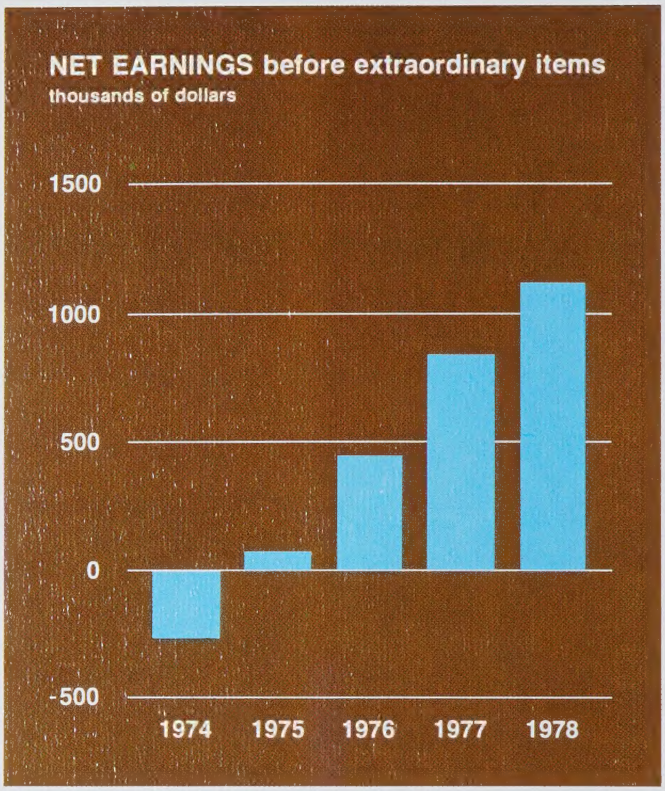
Revenue

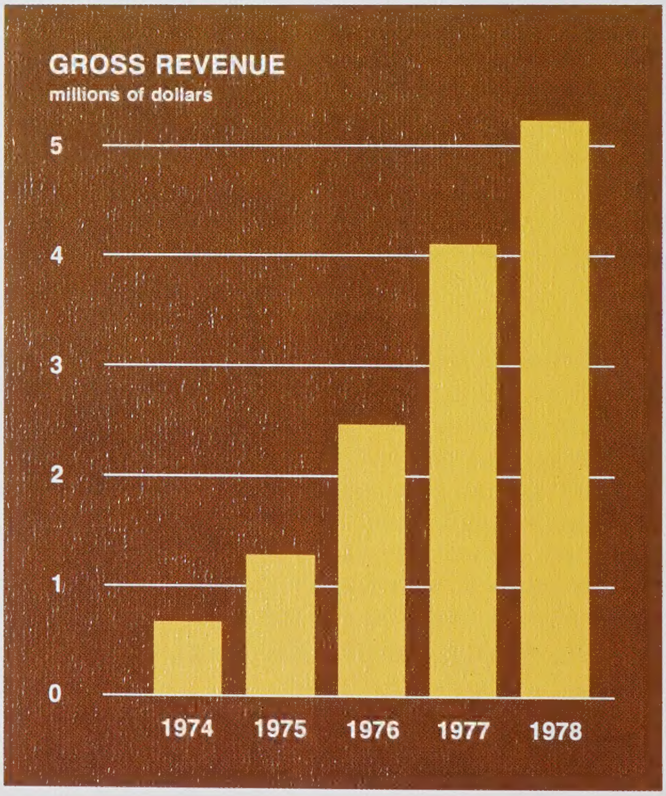
Total revenues for the fiscal year aggregated to $5,214,608 up 27.5% over last year's $4,090,062. The increase in revenues is attributed to increased sales volumes of oil and gas and higher wellhead prices. Wellhead prices for natural gas increased to $1.54 from last year's $1.18 and oil prices similarly increased from $9.75 to $11.75 per barrel.

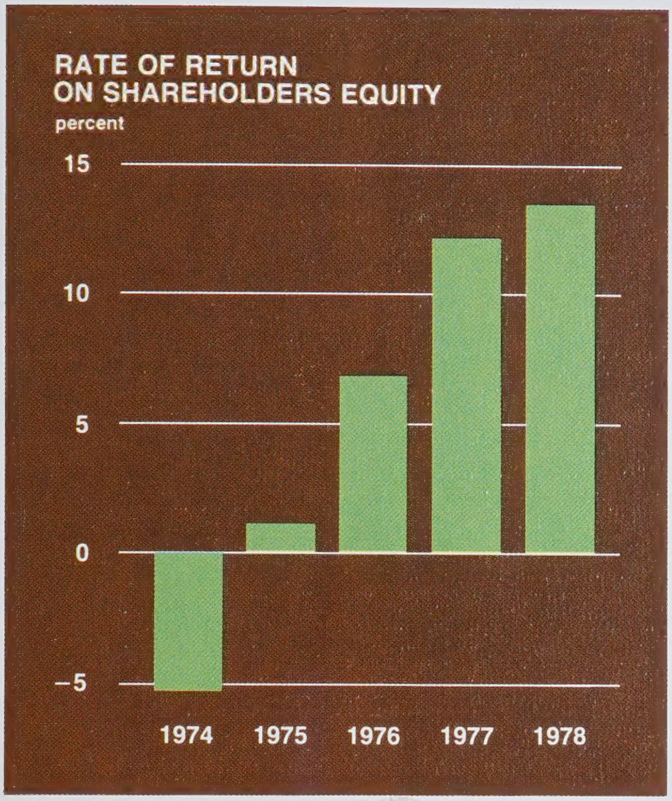
Expenses

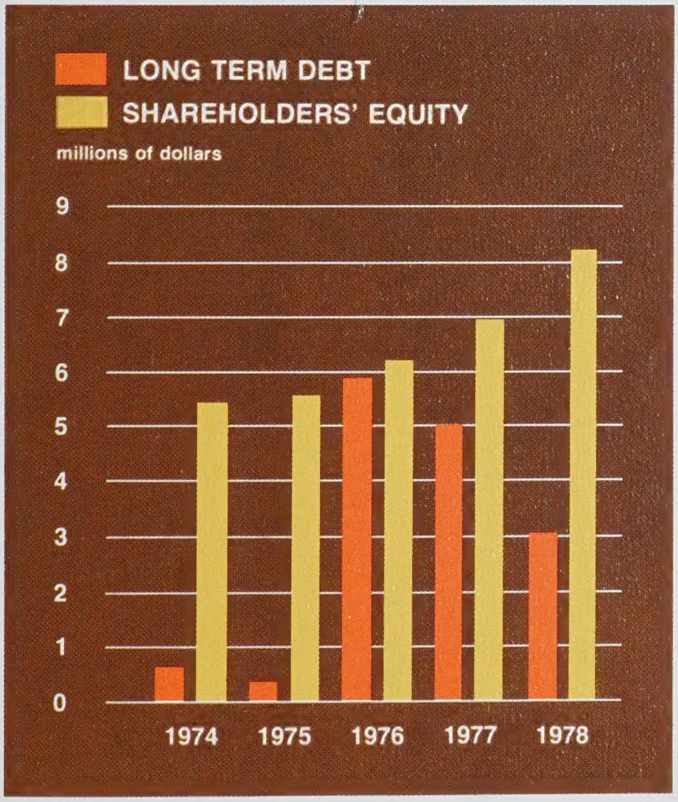
Operating expenses increased slightly to $1,229,000 from $928,000 last year. Increases in general and administrative expense, depletion and depreciation were commensurate with increases in the company's activities. Interest paid on bank loans decreased sharply from $625,166 to $386,548 in line with a 40% reduction in outstanding loans.

Expenses related to dry holes and abandonments increased to $756,659 as compared to last year's $209,409.









Income Taxes

Although the company recorded a cash income tax liability last year of $58,000, incurred by one of its subsidiaries, no taxes are payable this year due to increased exploration expenditures.

Changes in financial position

Working capital decreased by $1,000,000 to $350,000 in line with a $1,000,000 increase in "Property, plant and equipment" as represented by production facilities at Battle Creek and lease acquisitions.

The company's bank loan was reduced by $1.9 million or 40%. Cash flow increased 48% from $2.3 million ($.83 per share) to $3.4 million ($1.20 per share).

Outlook for 1978/1979

Keeping in mind the hazards of making a forecast for the coming year and stressing the unpredictability of the marketing of natural gas in Canada it is estimated that earnings for next year will rise to $0.80 per share and cash flow will increase to $1.25 per share.

During the year ending May 31, 1978, Peyto and subsidiary companies participated in the drilling of 43 wells. Of that total 15 were drilled in Alberta, 1 in British Columbia, 27 in the U.S.A., of which 22 were in the Battle Creek field in Montana, 1 in Texas, 1 in California, 3 in Indiana and 1 offshore in the U.K.

This drilling program resulted in 1 oilwell, 24 gaswells and 19 dry holes. In addition, 11 wells were drilled at no direct cost to your company on lands in which your company has an interest resulting in 1 oilwell in offshore Tunisia, 1 gaswell in Alberta and 9 dry holes.

The larger number of dry holes participated in is in part explained by the more aggressive exploration stance taken by your company, made possible by a larger exploration budget this year. Since this fiscal year end the company participated in an additional 13 gaswells, 1 oilwell and 6 dry holes.

Western Canadian oil and gas lease prices have escalated very substantially over the last year, lead by success at Pembina and Elmworth in Alberta, making lease acquisitions expensive and difficult for the smaller exploration companies. This situation is enigmatic since gas sales contracts are at present unavailable. A decision by our Federal Parliament to allow additional gas exports to the U.S. is eagerly hoped for by the industry. Your management is of the opinion that the U.S. still holds great potential for the discovery of hydrocarbons and it is an area where lease costs are considerably lower than Western Canada. Since our income from Montana production will increase sharply this year, plans are underway to expand our exploration efforts in the U.S.A.

This year our maps highlight exploration prospects in British Columbia, North Dakota and Offshore Australia in order to indicate the diversity and wide ranging areas of oil and gas exploration in which your company is involved. The following is a more detailed summary of these exploration activities.

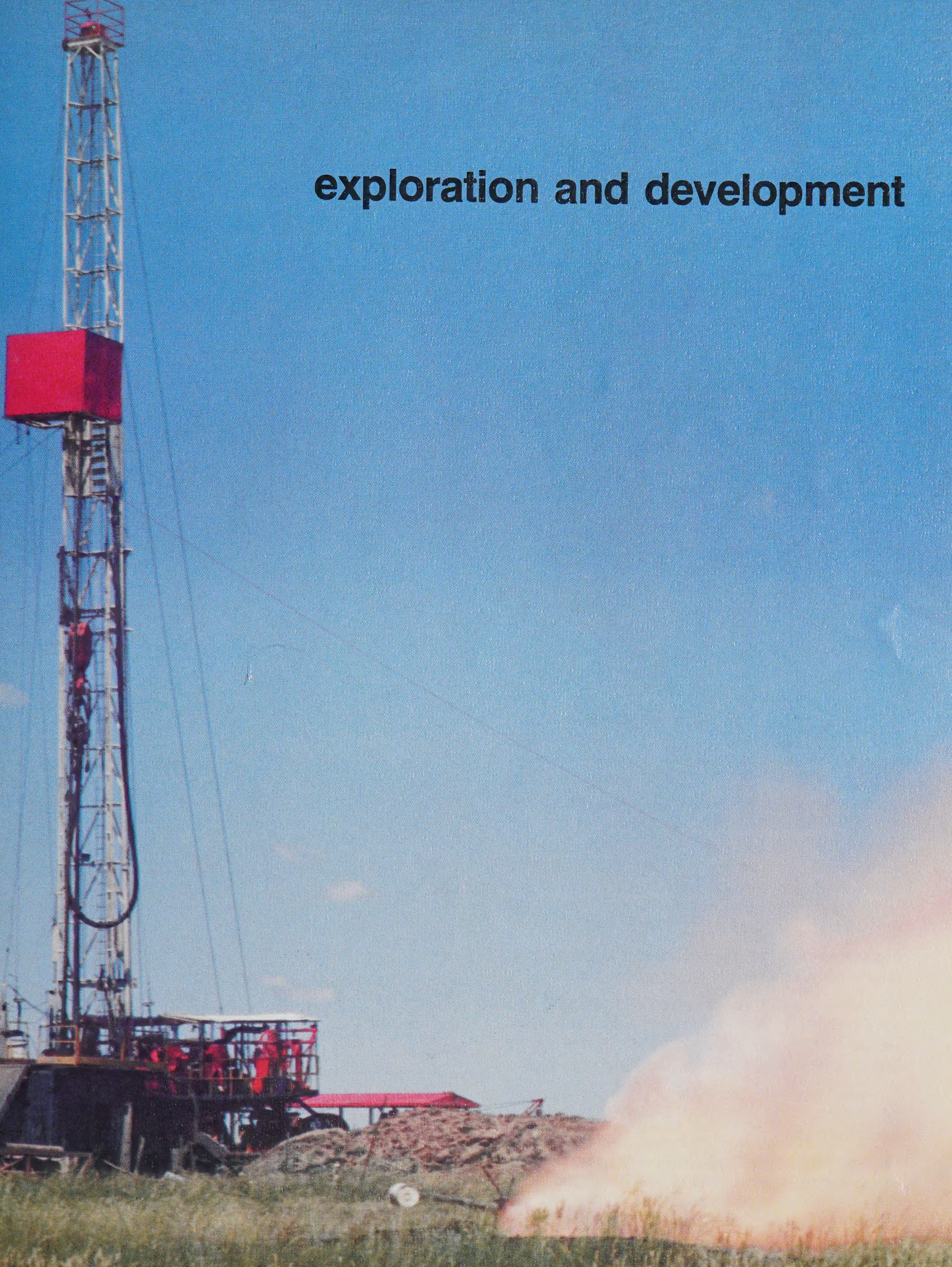
WESTERN CANADA

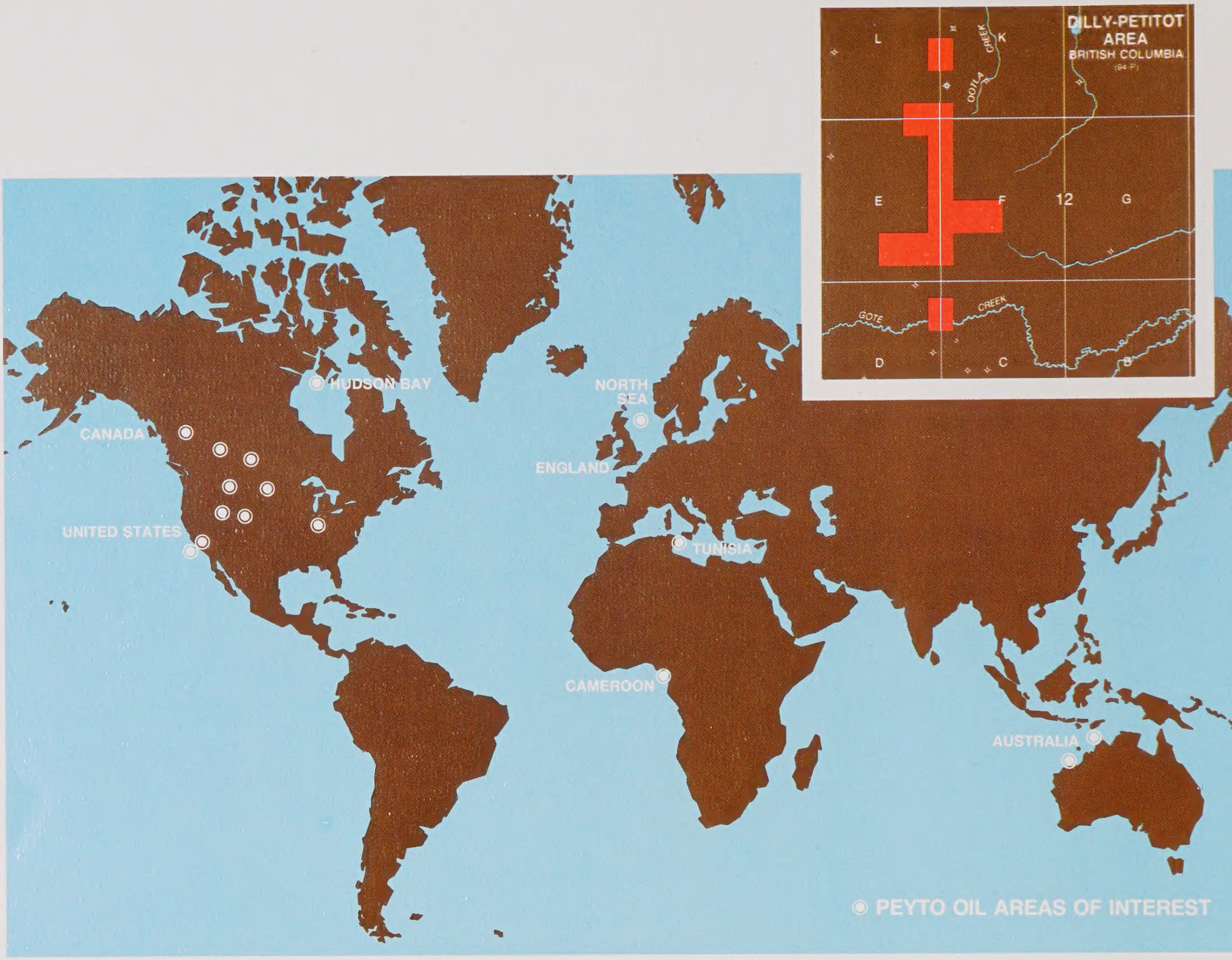
Alberta

A farmin at Majorville on 12,000 acres is currently being developed. Two gaswells and 2 dry holes were participated in by your company as to a $37^1/_2\%$ interest. Additional seismic data is being obtained and a possible 3 additional wells may be drilled. No gas contract is available at this time.

Chouteau 1-4 tested gas at 3.7 MMcf/d Battle Creek, Montana.

exploration and development





Peyto Oil Interest Acreage

O LOCATION -◇- ABANDONED ☼ GAS WELL ● OIL WELL

At Pearson Lake, your company obtained ±30% interest in a 6,000 acre farmin and participated in the drilling of 3 gaswells and 1 indicated oilwell. These lands are contracted to TransCanada Pipelines and production is expected to commence shortly.

At Quirk Creek, 1 infill well resulted in a gaswell and one 12,000 foot stepout test was abandoned.

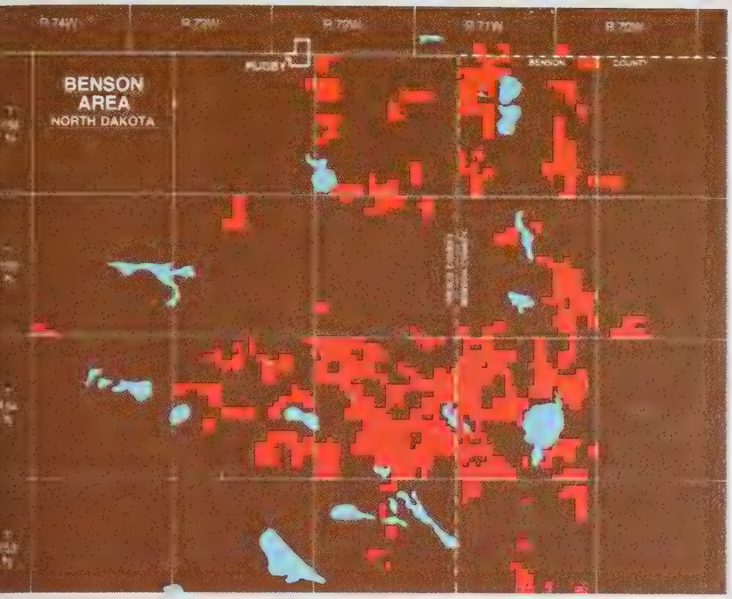
In the Karr area Peyto acquired two leases during 1976 and 1977. Recent drilling in the area by industry has resulted in several gaswells and indicates proven gas reserves under the Peyto acreage.

At Ferrier and Sunchild leases have been acquired on Cretaceous oil prospects. Drilling is planned for the coming year.

Peyto is participating in the drilling of a well at Skaro which will be located on a dramatic electrical anomaly which we hope is related to Leduc Reef development.

British Columbia

In the Nig Creek and Wildmint areas, leases were acquired on Cretaceous and Triassic prospects. Seismic and/or drilling of the leases is planned for this winter.



Your company participated for a 25% interest in the acquisition of a 2,357 acre drilling reservation located on an excellent seismic Devonian Reef anomaly in the Dilly-Petitot River area. Further seismic evaluation and drilling is planned in the near future.

UNITED STATES

Montana

Exploration and development are continuing on our 125,000 acres of leases at Battle Creek (see also production section). Additional wildcat wells are being planned to investigate additional potential accumulations. Due to the proximity to Alberta and the similarity of Montana's geology Peyto is actively investigating additional prospects in Western Montana.

North Dakota

Peyto plans active participation in the Williston Basin of North Dakota (see map) where a significant oil discovery by Shell Oil in the Ordovician Cambrian, Deadwood and Winnipeg Sandstone during 1977 resulted in a high level of exploration in the Basin. Peyto has acquired a 75% interest in approximately 49,250 gross acres in the Basin. The granting of a seismic drilling option to another company is under negotiation. This could result in early exploration of this prospect.

Utah

Presently we are waiting on a drilling rig capable of reaching a depth of 10,500 feet to drill on a 4,000 acre farmin which we have concluded in the Uinta Basin of northern Utah. The test well is located adjacent to a well which in its $3^1/_2$ year life has produced 280,000 barrels of oil and $^3/_4$ of a billion cubic feet of gas.

Indiana

Three additional shallow wells are scheduled to be drilled this summer in Indiana. This is a continuation of a wildcat play which commenced last year on 7,200 acres and will earn your company a $12^1/_2$% interest.

Colorado

On 6,800 acres in which your company owns a 50% interest, Damson Oil has committed to drill a Niobrara test well this year on the lands at no cost to Peyto.

California

On the Cuyama prospect in California, 1,240 acres, the well in which we participated last year was dry, however, we expect a second well will be drilled on the prospect by others to explore the deeper potentials.

Currently farmout attempts are underway regarding the 28,800 acre Offshore California concession in which your company holds a $6^1/_4$% interest. It is hoped that this acreage will be drilled in the coming year.

International

U.K. Offshore

A deep test drilled in our Block 211/2 by British Petroleum was unsuccessful. Evaluation of the block is continuing. All drilling information obtained from the well remains confidential.

Block 3/7 — following the drilling of 2 uneconomical oilwells and 1 dry hole on the block the company accepted an offer from Deminex for the outright sale of the shares of our U.K. subsidiary. The sale is subject to approval of certain regulatory authorities. If approved the net proceeds to our company will be approximately $1,600,000 after taxes.

The company is involved in a new offshore license application to the U.K. Government for the Sixth Round of Awards.

Tunisia

A second oil well, Yasmin #2, and a further unsuccessful wildcat Mimosa #1, were drilled on a farmout from the company by others. The oil well flowed 2,600 barrels of light crude oil on test. It is located in 400 feet of water, some 35 miles offshore Tunisia. Further evaluation drilling and economic development studies are needed before production can proceed.

Your company's interest in the 1 million acre concession is 1.7855%.

Cameroon

Gulf Oil has farmed in to our 185,200 acre offshore concession and will earn an interest upon completion of a one million dollar seismic survey, currently in progress.

Australia

Minor exploration has been carried out on two concessions totalling 9,600,00 acres in which your company owns a 10% interest, located offshore on the Australia Northwest Shelf. The delay has been caused by the shortage of seismic vessels. The exploration climate is improving in Australia with the demise of the Labor Government. The current conservative government is anxious to encourage exploration and it is hoped that exploration partners will be found to aid in the exploration of the large tract.

production

The natural gas surplus situation appears to be worsening in Alberta. It is truly an example of the "free" market operating in a traditional manner. High gas prices (as set by negotiations between Alberta and the Federal Government) induce exploration companies to step up exploration for natural gas and also bringing into production smaller accumulations of natural gas heretofore uneconomic. The surplus has been building for at least two years and many new fields are shut in due to lack of new gas contracts. Canada's domestic market is pretty well saturated and expansion now relies on a normal growth rate of ±5%. The industry has been clamoring to open new markets via export to the U.S.A but the Canadian Government is at present reluctant to allow such exports until they are satisfied that an exportable surplus exists and all domestic markets fully exploited. Areas not now served by natural gas from Alberta such as Vancouver Island, the area east of Montreal and the Maritimes are small, and at present served by other sources of energy such as imported oil. The Government argues that a price reduction of natural gas could penetrate these small and distant markets. It is enigmatic that it was the granting of higher prices in the first place that brought forth large quantities of new Alberta gas, and it is the industry's opinion that a lowering of the price would be self defeating in that exploration for natural gas would be reduced sharply starting the whole circle of scarcity, higher prices and surpluses all over again.

Both oil and gas production levels increased to 932 barrels and 6.9 MMcf per day despite severe curtailment of production at Quirk Creek and Lacombe. Quirk Creek, one of our larger producing areas was cut back to 65% of last year's production due to Alberta's gas surplus. The TransCanada Pipeline gas purchase contract contains a "pay or take" clause whereby the buyer is obligated to pay for a certain minimum yearly quantity of gas, irrespective of whether the gas is produced. A payment for this gas will be made to the company in December 1978.

Oil and gas production in our Turner Valley properties continued satisfactorily throughout the year. Shareholders might recall the purchase of this property in 1976, which was financed by a bank loan. Repayment of this loan out of production proceeds is well ahead of schedule resulting in reduced interest charges in the coming year.

Pending enlargement of the gas market our shut in reserves at Seebe Ghost, Karr and Majorville will remain shut in and exploration for new reserves will be limited to drilling on lands under gas contracts and exploratory drilling for major reserves where the lag time between discovery and production is generally 2 to 3 years.

At Battle Creek, Montana the gas plant was deemed operative on August 28, 1978 causing the "pay or take" provision of the gas contract to take effect. The buyer is completing a 22 mile pipeline and actual production will start in approximately two months. Twenty gaswells are now connected to the gathering system and compression facilities and production will be at the rate of 10 million cubic feet per day for an initial 9 month period, reverting thereafter to a reserve type contract. The sales price of the gas is in excess of U.S. $2 per 1,000 cubic feet. Your company has a net 18% interest in this development.

Following is a breakdown of the cash flow figures derived from a recent evaluation made by McDaniel Consultants (1965) Ltd. of your company's reserves. The production figures cover a 20 year period effective May 31, 1978 and are based on certain assumptions such as reservoir performance, price and operating costs increases etc., over this time period. The company's reserves have been reviewed yearly over the last 4 years and adjustment made in quantities of oil and gas in the ground. This year despite increases in new reserves found our reserves estimates were revised downward somewhat. Subsequent performance of the reservoirs may increase or decrease reserves.

CASH FLOW SUMMARY AS OF MAY 31, 1978 CALCULATED FOR A 20 YEAR PERIOD
(based on a reserve evaluation by McDaniel Consultants (1965) Ltd.)

Reserves		**Gross Revenue**	**Royalties**	**Operating Expenses**	**Capital Costs**	**Net Revenue**
Oil . .	(5,218,000 Bbls.)					
Gas .	(62,366,000 Mcf)	$198,558,000	$52,962,000	$50,367,000	$4,801,000	$90,429,000
Sulphur	(170,000 Tons)					

Net Revenue discounted at:

0%	12%	15%	18%
$90,429,000	$37,559,000	$32,282,000	$28,278,000

Quirk Creek Gas Plant.

Consolidated Balance Sheet May 31, 1978

(With comparative figures for 1977)

ASSETS

	1978	1977
Current assets:		
Cash	$ 340,547	$ 26,357
Deposit receipts, including accrued interest	503,886	806,217
Accounts receivable	863,172	964,395
Total current assets	1,707,605	1,796,969
Property, plant and equipment, at cost (Notes 2 and 3)	15,252,791	13,584,634
Less accumulated depletion and depreciation	2,989,094	2,122,402
	12,263,697	11,462,232
Other assets:		
Investments, at cost less amounts written-off (quoted market value $100,033; 1977 — $126,747)	108,799	111,148
Other investments, at cost less amounts written off (no quoted market value)	77,226	77,226
Notes receivable (Note 4)	89,300	38,500
Refundable deposits	35,182	11,034
Incorporation costs	9,374	10,039
	319,881	247,947
	$14,291,183	$13,507,148

See accompanying notes.

LIABILITIES

	1978	1977
Current liabilities:		
Demand bank loans	$ 376,720	$ 114,108
Accounts payable and accrued liabilities	980,611	254,416
Income taxes payable, subsidiary company	—	58,000
Total current liabilities	1,357,331	426,524
Bank loan (Note 3)	3,050,000	5,000,000
Minority interest in subsidiary company	207,921	237,896
Deferred revenue	46,437	119,400
Deferred income taxes	1,478,391	743,391
Shareholders' equity:		
Share capital (Note 4):		
Shares without nominal or par value.		
Authorized 6,000,000 shares; issued 2,854,583 shares (1977 — 2,843,583 shares)	6,326,962	6,265,977
Retained earnings	1,824,141	713,960
	8,151,103	6,979,937
	$14,291,183	$13,507,148

Approved on behalf of the Board:

R. T. VANDERHAM, Director

W. WOLODARSKY, Director

Consolidated Statement of Earnings Year ended May 31, 1978
(with comparative figures for 1977)

	1978	1977
Revenue:		
Oil and gas	$5,037,887	$3,880,448
Interest earned	60,575	88,817
Management and other income	105,634	64,730
Gain on sale of properties and investments	10,512	56,067
	5,214,608	4,090,062
Expenses:		
Operating	1,228,633	927,847
Lease rentals, on non-producing properties	54,425	45,246
Geological and geophysical	90,685	12,137
General and administrative	321,374	240,073
Interest — long-term	386,548	625,166
Depletion	552,120	531,027
Depreciation	314,572	230,914
Dryholes and abandonments	756,659	209,409
	3,705,016	2,821,819
Earnings before income taxes, minority interest and extraordinary item	1,509,592	1,268,243
Income taxes:		
Current	—	58,000
Deferred	735,000	498,000
Province of Alberta Royalty Credit	(307,382)	(216,118)
	427,618	339,882
Earnings before minority interest and extraordinary item	1,081,974	928,361
Minority interest in earnings (loss) of subsidiary	(28,207)	70,447
Earnings before extraordinary item	1,110,181	857,914
Extraordinary item:		
Write down of certain investments to market value	—	121,900
Net earnings	$1,110,181	$ 736,014
Net earnings per share (Note 5):		
Before extraordinary item	$ 0.39	$ 0.30
Extraordinary item	—	(0.04)
	$ 0.39	$ 0.26

See accompanying notes.

Consolidated Statement of Changes in Financial Position
Year ended May 31, 1978
(with comparative figures for 1977)

	1978	1977
Working capital was provided from:		
Earnings before extraordinary item	$1,110,181	$ 857,914
Add items not affecting working capital	2,319,632	1,483,730
Working capital provided from operations	3,429,813	2,341,644
Increase (decrease) in deferred revenue	(72,963)	119,400
Issue of share capital	60,985	38.500
Proceeds on sale of properties and investments	12,862	82,652
	3,430,697	2,582,196
Working capital was used for:		
Property, plant and equipment	2,422,156	1,435,390
Decrease in bank loans	1,950,000	830,000
Increase in other assets	74,948	35,336
Purchase of additional shares of a subsidiary	3,764	—
	4,450,868	2,300,726
Increase (decrease) in working capital	(1,020,171)	281,470
Working capital, beginning of year	1,370,445	1,088,975
Working capital, end of year	$ 350,274	$1,370,445

Consolidated Statement of Retained Earnings
Year ended May 31, 1978
(with comparative figures for 1977)

	1978	1977
Retained earnings (deficit), beginning of year	$ 713,960	$ (22,054)
Net earnings	1,110,181	736,014
Retained earnings end of year	$1,824,141	$ 713,960

See accompanying notes.

Notes to the Consolidated Financial Statements May 31, 1978

1. **Significant accounting policies:**

Principles of Consolidation:

The consolidated financial statements include the accounts of all wholly-owned subsidiary companies and an 83% held subsidiary, Giant Reef Petroleums Limited.

The excess of the purchase price of the shares of Giant Reef Petroleums Limited over the underlying net book values, at dates of acquisition, has, on consolidation, been added to the cost of developed oil and gas properties and is being depleted on the unit-of-production method.

Petroleum and Natural Gas Properties:

Under the successful efforts method of accounting as used by the company (as opposed to the "full cost" method) all costs relative to exploration and development of petroleum and natural gas whether productive or non-productive are initially capitalized. The costs of non-producing properties, including development and exploration thereon, less any proceeds on disposal, are charged against earnings in the year of disposal, abandonment or surrender. Costs pertaining to producing properties are depleted on a unit-of-production method based on estimated proven reserves. Carrying costs on undeveloped properties are charged against earnings in the year incurred.

Depreciation:

Lease and well equipment and gas plants are being depreciated on the composite unit-of-production method. A subsidiary company's gas plant is being depreciated on the straight-line basis using a rate of 5 percent per annum.

Income taxes:

The company follows the tax allocation basis of accounting for all timing differences between net earnings and taxable income.

2. **Property, plant and equipment:**

	1978			1977
	Assets at cost	Accumulated depreciation and depletion	Net	Net
Developed oil and gas properties and equipment thereon	$10,981,878	2,278,562	8,703,316	8,449,557
Gas plants	2,644,144	710,532	1,933,612	2,041,057
Undeveloped oil and gas properties	1,626,769	—	1,626,769	971,618
	$15,252,791	2,989,094	12,263,697	11,462,232

3. **Bank loan:**

A production bank loan in the amount of $3,050,000 is repayable out of future production proceeds, and accordingly, is not expected to require the use of existing working capital; therefore, no portion of this loan has been reclassified to current liabilities. Principal payments to meet the next fiscal year's instalment on this loan are estimated at $600,000.

4. **Share capital:**

During the year the company issued 10,000 shares to employees under a stock purchase agreement at a price of $5.85 per share. The amounts due under the purchase agreements are secured by the shares issued and non interest bearing notes due in instalments over ten years.

At May 31, 1978 the company has reserved 10,000 shares for employee stock options. The options are exercisable one fifth each year on a cumulative basis at a price of $2.485 per share, expiring on September 5, 1979 or 60 days after termination of employment whichever comes first. During the year, options for 1000 shares were exercised at a price of $2.485 per share and options for 2300 shares were cancelled as a result of termination of employment.

Under a drilling program agreement, the company has granted options to purchase up to 160,000 shares at a price of $5.50 per share. The options expire on December 30, 1978.

5. **Net earnings per share:**

The net earnings per share are calculated using the weighted average number of shares outstanding during the year. Fully diluted earnings per share are not presented as there would be no material change.

6. **Anti-Inflation:**

The company is subject to the provisions of the Anti-Inflation Act and Regulations governing the amount of dividend payments and as a result the amount of dividends which may be paid is restricted.

7. **Remuneration of directors and officers:**

The aggregate remuneration paid to senior officers (as defined by The Companies Act, Alberta, which term includes the five highest paid employees of the company) during the year amounted to $143,780 (1977 - $110,327). No remuneration was paid to directors as such.

8. **Subsequent event:**

Subsequent to May 31, 1978 the company under the terms of a letter of agreement proposes to sell, subject to approval of certain regulatory authorities, all of the shares of its wholly-owned subsidiary company Peyto Oils (U.K.) Ltd. The proposed sale will result in an extraordinary gain, net of income tax of approximately $1,600,000.

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Peyto Oils Ltd. as at May 31, 1978 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at May 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Canada
August 31, 1978

Peat, Marwick, Mitchell & Co.
Chartered Accountants

5 YEAR SUMMARY

	1978	1977	1976	1975	1974
REVENUES					
Oil & Gas Sales	$ 5,037,887	$3,880,448	$2,270,915	$ 913,757	$521,113
Other Income	176,721	209,614	200,735	359,289	138,974
Total	5,214,608	4,090,062	2,471,650	1,273,046	660,087
EXPENSES					
Operating	1,228,633	927,847	590,519	240,549	168,787
Lease rentals on non-producing prop.	54,425	45,246	38,152	45,718	72,508
Geological & Geophysical	90,685	12,137	—	—	—
General & Administration	321,374	240,073	219,840	165,680	160,209
Interest (long term)	386,548	625,166	312,109	66,901	66,411
Depletion & Depreciation	866,692	761,941	479,387	245,612	224,586
Dry holes & abandonments	756,659	209,409	221,047	262,587	262,572
	3,705,016	2,821,819	1,861,054	1,027,047	955,073
EARNINGS (loss) before income taxes, minority interest & extraordinary item	1,509,592	1,268,243	610,596	245,999	(294,986)
INCOME TAXES					
Current	—	58,000	—	—	N.A.
Deferred	735,000	498,000	266,354	165,525	N.A.
Prov. of Alta. Royalty Credit	(307,382)	(216,118)	(130,490)	(47,721)	N.A.
	427,618	339,882	135,864	117,804	N.A.
EARNINGS (loss) before minority interest & extraordinary item	1,081,974	928,361	474,732	128,195	(294,986)
Minority interest on earnings (loss) of subsidiary	(28,207)	70,447	38,907	57,048	(3,103)
EARNINGS (loss) before extraordinary item	1,110,181	857,914	435,825	71,147	(291,883)
Extraordinary item	—	(121,900)	38,051	111,861	—
NET EARNINGS (loss)	1,110,181	736,014	473,876	183,008	(291,883)
Net earnings/share					
Before extraordinary item	.39	.30	.16	.02	(.10)
Extraordinary item	—	(.04)	.01	.04	—
	.39	.26	.17	.06	(.10)
BALANCE SHEET ITEMS					
Working capital	$ 350,274	1,370,445	1,088,975	2,363,627	2,449,432
Investments	186,025	188,374	317,472	476,803	469,311
Property plant & equipment (net)	12,263,697	11,462,232	11,017,579	3,490,352	3,358,705
Production loan	3,050,000	5,000,000	5,830,000	370,000	604,000
Deferred income taxes	1,478,391	743,391	245,391	25,003	—
Minority interest	207,921	237,896	167,449	233,184	153,861
Shareholders equity	8,151,103	6,979,937	6,205,423	5,726,080	5,543,072
Retained earnings (deficit)	1,824,141	713,960	(22,054)	(495,930)	(678,938)
Shares outstanding	2,854,583	2,843,583	2,833,583	2,831,383	2,831,383
No. of shareholders	1,311	1,460	1,425	1,447	1,282
Share volume	n/a	2,409,367	1,766,710	1,206,795	2,559,131
$ Value of shares traded	n/a	19,096,217	8,551,879	4,421,874	17,398,833

	1978	1977	1976	1975	1974
CHANGES IN FINANCIAL POSITION					
Sources of funds					
Earnings before extraordinary item	1,110,181	857,914	435,825	71,147	(291,883)
Add items not affecting working capital	2,319,632	1,483,730	969,431	729,527	496,078
Working capital provided from operations	3,429,813	2,341,644	1,405,256	800,674	204,195
Increase (decrease) in deferred revenue	(72,963)	119,400	—	—	—
Issue of share capital	60,985	38,500	5,467	—	2,212,500
Proceeds from bank loan	—	—	5,580,000	—	—
Proceeds on sale of property & investments	12,862	82,652	249,253	13,051	5,415
	3,430,697	2,582,196	7,239,976	813,725	2,422,110
Uses of Funds					
Property Plant & Equipment	2,422,156	1,435,390	8,095,710	659,144	538,648
Decrease in bank loan	1,950,000	830,000	120,000	234,000	28,000
Increase in other assets	74,948	35,336	54,410	—	35,220
Purchase of additional shares in Subsidiaries	3,764	—	244,508	6,386	5,172
	4,450,868	2,300,726	8,514,628	899,530	607,040
Increase (decrease) in Working Capital	(1,020,171)	281,470	(1,274,652)	(85,805)	1,815,070
Working Capital beginning of year	1,370,445	1,088,975	2,363,627	2,449,432	634,362
Working Capital end of year	350,274	1,370,445	1,088,975	2,363,627	2,449,432

	1978	1977	1976	1975	1974
Proven Oil and Condensate	3,460,628	3,639,980	3,945,682		
Probable Oil and Condensate	1,757,478	2,065,238	2,574,853		
Total in barrels	5,218,106	5,705,218	6,520,537	N/A	N/A
Average Daily Production Bbls./Day	932	856			
Proven Gas**	49,252	49,531	42,330		
Probable Gas	13,114	13,961	11,201		
Total in MMcf	62,366	63,492	53,531	N/A	N/A
Average Daily Production MMcf/day	6.9	6			
Proven Sulphur	114,810	110,393	93,305		
Probable Sulphur	55,514	56,651	56,905		
Total in Long Tons	170,324	167,044	150,210	N/A	N/A
Gross Wells Drilled	43	21	20	13	20
Oil and/or Gas	25	13	11	9	10
Dry and Abandoned	18	8	9	4	10
No. of employees	5	6	5	4	5
Land Holdings					
Canada — Gross Acres	1,484,139				
— Net Acres	177,775				
Elsewhere — Gross Acres	11,429,820				
— Net Acres	1,111,497				
Total — Gross Acres	12,917,959				
— Net Acres	1,289,272				

For Evaluation SEE PRODUCTION SECTION McDaniel Consultants (1965) Ltd., Calgary

***not inclusive of 32,000 MMcf attributable to the revenues allocated to Turner Valley Gas Plant from which 20¢/Mcf is collected when processed.*

lawson graphics western limited
PRINTED IN CANADA

Peyto Oils Ltd.